

Ukraine and Russia SME Development Policy Analytical Survey

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SECTION I. KEY FINDINGS OF THE SURVEY. COMPARATIVE ANALYSIS

This report outlines major conclusions and factors that influence the level of small business development and small business development policy in Ukraine and Russia. This paper presents the findings of the survey of SME development policy in Ukraine and Russia, which was conducted in June-August 2002. The survey included analysis of information and analytical materials received in both countries. **As viewed by the experts who conducted this survey**, *understanding the patterns* specified in the survey *and their further use* under the current level of recognition by society of the role played by small business sector, will secure the enhanced effectiveness of small business policy.

SMALL BUSINESS SECTOR IN UKRAINE AND RUSSIA

Both in Ukraine and Russia there exists a myth about the underdeveloped SME sector. This myth is based on inadequacy of statistic data and poor understanding of what SME sector actually is. In both countries the official statistic is kept on small businesses registered as legal entities. This indicator per 1000 of population constitutes 4.8 for Ukraine and 6.1 for Russia. Meanwhile, in both countries private entrepreneurs – natural persons represent the major constituent of small business sector. Considering this constituent, numeric indicator of small businesses per 1000 of population would be 35 for Ukraine and 38 for Russia. This numeric indicator is close in its value to that of the developed European countries.

Therefore, we can state the fact that the SME sector has already established in both countries, is undergoing further development and is quite perceptible in social and economic environment of both Ukraine and Russia.

ATTITUDE TO SMALL BUSINESS AND ENTREPRENEURSHIP

The level of small business development depends significantly on the society's attitude to small business and entrepreneurship in general.

Small business sector develops under the influence of numerous factors: macroeconomic situation, solvent demand of population, regulatory environment, etc. But the capacity of small business to overcome the negative impact of these factors or benefit from their positive influence depends on the society's attitude towards demonstration of entrepreneurial initiative.

Society

For ten years of the course towards the creation of market economy the society has passed various stages of attitude to entrepreneurship: from the “speculator” label to certain level of recognition of private imitative as a factor of democracy and foundation for emergence of a middle class. The status of society attitude to small business can only be modeled based on expert assessments (the authors never heard about any sociological surveys on this issue). We can state, however, that in both countries the attitude towards small entrepreneurship has already passed the stage of

hostility, is characterized by neutral and certain positive tones but demonstration of private initiative is still to become national priority.

The State

Both countries declared the recognition of entrepreneurship as economic and social foundation of society. However, this declaration is just the first step towards understanding the actual role played by entrepreneurship and small business in particular. Both countries adopted laws that declare the policy for small business support and determine the role of small business in society.

However, the survey of actual attitude of state officials to small business proves that it is either neutral or protectional for “friendly” businesses and hostile to “foes”.

Real policy related to small business is implemented only by special agencies (both countries have respective agencies responsible for small business development). However, this policy, despite active political will displayed by the presidents of both Ukraine and Russia, failed to become a national one.

The administrative system of both countries, while recognizing certain advantages offered by small business development, perceives in it certain threats for itself.

Advantages and disadvantages of small business for existing state governance system

Advantages	Disadvantages
Creation of new jobs without budget funding	Economic independence of businesses, which decreases their dependence on the state
Reduction of social tension in society	Self respect of businesses(based on their independence)
Absorption of excessive labor force on the labor market	Strengthening the principles of civil society
Proceeds to the budget (of all levels)	Demands for improved transparency for state authorities
Economic development resulting from social significance of small business	Demands for improved accountability on the part of state authorities

Contradictions between unreformed administrative system oriented towards administrative and command methods and quantitative growth of the sector of independent businesses opposed to command methods results in administrative barriers for small business development.

LEVEL OF POLICY DEVELOPMENT AND LEVEL OF SECTOR DEVELOPMENT

The development level and policy effectiveness are determined by the activity of small business sector.

The growth of small business sector results in its increased importance in the life of society. Accordingly, this leads to improved understanding on the part of state authorities of the necessity to address problems existing in small business sector.

In Russia, it is recognized that small business development occurred despite rather than due to state policy.

In Ukraine, all major policy achievements that stimulated quantitative growth and strengthening of small business sector (simplified taxation methods, deregulation) resulted from demands and active pressure of small business sector on state power.

Gradually, the sector itself is becoming the center of influence on formulation of real small business policy. Until recently, the formal policy was greatly influenced by international organizations implementing technical assistance programs in Ukraine. The effectiveness in formulation of real policy will increase if technical assistance factor takes due account of signals communicated by small business sector. In this case double influence on state power will bring about significant results.

ROLE OF THE STATE IN SME SECTOR

The substance of small business policy depends on existing understanding of the state's role in sector development

Major current policy provisions: the state governs sector development, the state determines development trends, the expediency for and goals of sector development, etc. In other words, the state determines and plans the goals and uses small business to achieve these goals.

This perception of the role played by the state gives rise to other ideas currently expressed in Ukraine: small business does not fulfill its social function, unsatisfactory small business structure (both from the point of view of industry structure, and proportion between legal entities and natural persons-subjects of business activity).

There is no recognition of the fact that **under conditions of market economy** the state **cannot govern** small business development, that this development is caused by numerous objective reasons and the state should react to the signals communicated by small business sector and adopt decisions that resolve existing problems.

Due to this improper understanding of the state's role we can observe the attempts to impose certain things the sector has no need of and lack of attention to actually recognized needs.

The sector does not develop according to the state plans. **The time is coming to shift from the policy of support through the policy of development to the policy of partnership.** A long-term strategy should be to transfer from partnership towards perceiving the state as a mechanism for implementing the interests of small business sector. But partnership is the result of efforts undertaken by both the state and small business sector.

INTERACTION BETWEEN THE STATE AND SMALL BUSINESS SECTOR

A mechanism for interaction between the state and small business sector is required to recognize the signals communicated by small business sector and formulate an effective policy in line with actual needs

We can name two major principles, which secure a more effective level of small business policy.

Principle of compliance – small business policy is effective when it complies with the needs and requirements of the sector and follows its interests.

To provide for successful policy the state should put in place the mechanisms that secure:

- Feedback from small business sector (its reaction on political, strategic and tactical decisions);
- Accurate and reliable information on the sector's problems and actual needs;
- Possibility for a dialogue on problems, interests and rights of small business.

Todate, there are examples of the first steps undertaken towards creation of such mechanisms. 40 subjects of Russian Federation created commissions on overcoming administrative barriers. Both business owners and representatives of entrepreneurs' public associations participate in the work of these commissions. Development and adoption of agreed upon resolutions called to foster business development in the regions is the major feedback resulting from the work of these commissions. The work is currently underway to create commissions on overcoming administrative barriers under the auspices of the authorized representatives of the President of Russian Federation in Federal Districts (constituencies).

A series of examples can also be observed in Ukraine. The Council of Entrepreneurs' Associations at the Governmental Committee for Economic Development of the Cabinet of Ministers of Ukraine, Public Collegium of DerzhPidrpyemnytstvo, and over 600 coordination boards on business development issues have been created in Ukraine. These coordination boards include both representatives from business community and state authorities. These coordination boards facilitate proper communication with small business sector and adoption of constructive decisions on respective levels of Government.

However, and this is true for both countries, the presence of such mechanisms does not automatically secure their proper functioning. Considering unresolved problems related to the attitude of society towards small business and changing the role of the state, it is hard to expect proper functioning of these mechanisms, which are the attributes of developed civil society. So far, state authorities in both countries are ready to accept only advice on the part of business community, and are not ready for a partner dialogue.

Principle of pressure – to secure an effective policy the small business sector must pay attention to its problems, represent its interests, and protect its rights.

The influence of small business sector grows with information pressure on key policy makers, when small business helps policy makers understand that implementing the interests of small business **offers certain specific advantages**.

There are examples of effective pressure both in Ukraine and Russia.

In 2001-2002, all-Russian conferences of small business representatives were held in Russia, which, as viewed by experts, gave significant impetus to policy development. Based on the results of these conferences, several Decrees of the President of Russia were adopted and state authorities undertook important organizational activities. A major consolidating force that organized these conferences and promoted implementation of their results was Russian Chamber of Industry and Commerce.

Ukraine can claim the examples of collective efforts resulting in nationwide campaigns to revoke harmful laws and law provisions. One of such campaigns against stamp duty (dates back to 1999) resulted in a law that canceled this duty. Another campaign back in the year 2000 against general use of electronic cash registers forced policy makers to amend respective law and limit the application of this fiscal control method. In the end of 2001 and early in 2002, small business sector launched one more significant campaign against the adoption of the Draft Tax Code of Ukraine that attempted to cancel all advantages of simplified taxation methods. Despite the fact that influential policy makers staked on the adoption of this Draft Tax Code and took no account of its destructive provisions, the pressure exercised by small business sector proved very effective and brought about desired results. Both parliament groups and the President of Ukraine reconsidered their attitude to the Draft Tax Code. Coordination and Expert Center of Entrepreneurs' Associations of Ukraine is an important consolidating element and served as a driving force during the above campaigns.

These examples prove that effective campaigns in Ukraine were conducted in a “firefighting mode”, that is reacted on unfavorable resolutions of state authorities. However, the formation of effective policy requires systematic impact and own clear vision of small business sector development.

SME SECTOR'S UNDERSTANDING OF ITS OWN ROLE

Effective policy can be achieved when small business sector comes to a certain level of self-realization: realization of its rights and interests, consolidation of forces, creation of mechanisms for exercising pressure and influence on state power.

In both countries small business sector has realized and separated its interests and rights. This is also reflected by large business rather harshly fighting against small business. This is especially true for the sectors where small business managed to create a significant competition: automobile transportation, retail trade, some types of services. In these case respective state authorities were also heavily pressured but this pressure was directed against small business sector. Effective policy can be achieved if this conflict is settled without the attempts to destroy certain layer of small business. Unfortunately these attempts are observed in both countries, e.g. refusal to issue permits on placement of small trade outlets (kiosks, stands, etc.) or administrative

intrusion in the form of unjustified inspections designed to close certain businesses, etc.

However, at the same time, small business sector in both countries is already setting for itself strategic goals and tries to consolidate efforts geared towards formulation of clear strategy for sector development.

In Russia, recommendations adopted by the above mentioned all-Russian conferences are the example of such efforts. In Ukraine – resolution of the Coordination and Expert Center of Entrepreneurs’ Associations of Ukraine to start the work (in cooperation with other interested organizations and institutions) on drafting strategic document regarding business development in Ukraine.

An importance factor that promotes self-realization for small business sector is the presence of common information space: printed mass media, TV and radio programs oriented towards small business sector and reflecting its needs and interests. Examples of efforts called to create such information space are: in Russia – specialized newspaper, in Ukraine – magazine “Pidpryemnytstvo” and some other specialized publications. But in Ukraine these publications do not have broad enough circulation and therefore failed to create the common information space. The first fiddle is played by weekly publications “Business” and “Halytsky Kotrakty”, which are commercial for-profit publications. However, the policy followed by the editorship of these publications contributed to formation of fundamentals for common information space.

NEW KNOWLEDGE

At current stage of small business development new knowledge tends to be of ever-growing importance for formulation and implementation of effective policy. This is essential for both state authorities and policy makers (in order not to adopt their decisions “at random”) and small business sector itself to foster self-realization and enhance impact on policy development.

Knowledge gains in importance when it becomes accessible for public at large. For example, tax authorities of both countries have data regarding operations of private entrepreneurs who are natural persons. However, there is no practice to generalize and publish this information, which makes it difficult to properly assess overall operation of small business sector.

Inadequate knowledge results in false conclusions. One of them is the myth regarding underdevelopment of small business sector described in Section 1 of this report.

There is also inadequate knowledge on public opinion regarding small business sector. This does not allow to effectively influence the formation of such opinion, which (as specified in Section 2 of this report) is essential for small business development.

Experts also conclude that both countries are **just beginning to realize the fact** that knowledge is a significant information resource equally important for small business development as finances or technology.

MAJOR RECOMMENDATIONS

The following recommendations can be made based on the survey findings:

Each conclusion requires a search for strategic decisions in specified areas (sections 2-7 of this report). It is proposed to establish the Expert Board under the auspices of the President or respective committee of Verkhovna Rada. This Board should include both specialists from state authorities and institutions, and representatives of public associations, unions, etc. This Expert Board can serve as a mechanism for joint search for strategic decisions.

It would be advisable to organize a broad discussion of survey findings and analytical materials accumulated during the survey. This discussion through mass media and regional and national level seminars attended by policy makers, officials, scientists, and representatives of business community can promote the adoption of effective strategic decisions.

To develop tactical decisions and the system of measures (in particular those that can serve as a foundation for the Measures Regarding Implementation of National Program for Promotion of Business Development in Ukraine) it would be advisable to create under the auspices of Derzhpidpryemnytstvo the task force groups to address the issues of each problematic area.

The conclusions prove the necessity for development of a new national document to outline (based on new understanding of the situation) a **new ideology** of interaction between the state and small business sector.

It is also expedient to conduct a sociological survey regarding society's attitude to small business.

CHAPTER 2: ANALYSIS OF SME SUPPORT POLICY IN UKRAINE

This document provides an expert evaluation of the effectiveness of Ukraine's small business support policy. It is based on the analysis of characteristics of the SME sector's development in recent years and a retrospective analysis of the interconnection between the policy development and the sector's development. During the evaluation we used the materials listed at the end of this report, feedback from SMEs and results of the series of focus groups that were conducted by the Institute of Competitive Society in 2001 and 2002.

1. POLICY CONTENT

The role and importance of small business in Ukraine have been subject of discussions on various levels for over 10 years. During this time the following idea has become commonly accepted: "SMEs make the economy flexible and strong, and bring it closer to the needs of individual consumers. SMEs also play an important social role as they create new jobs and provide a source of income for large groups of the population".[1]

A particular government policy (for example, small business support policy) is a combination of the content, forms and methods of exercising the power of the state in a particular field of the state's activity. It is characterized by a certain degree of independence, homogeneity and recurrence [4]. In a civilized and law-obedient country a government policy is implemented primarily by means of legal regulation.

One may often hear, especially from government representatives, that 'small business support has been one of the highest priorities in the government policy from the very first years of economic reforms. The important role of small businesses in creation of a competitive environment, ensuring flexibility of the national economy, creation of new jobs and increasing personal incomes has been recognized at all levels. The evidence of such recognition was the inclusion into the government policy of special measures to support business development in Ukraine"[1]

However, the reaction of small business sector indicates otherwise. It is the same issues that entrepreneurs keep mentioning as the main obstacles for business development – regulatory and administrative barriers, problems with obtaining permits, pressure of numerous inspections and frequent and inconsistent changes in legal regulation. [7].

Such facts prove the government policy ineffective. The negative feedback from entrepreneurs does not allow us to say that the government SME support policy is characterized by the unity of the content, forms and methods.

The criteria, which are used to determine whether the government has any particular SME support policy and whether such policy is effective, are, first of all, the statistics on the sector's growth, microeconomic indicators and, what is also important, the reaction of citizens to this policy.

1.1 The statistics on small business growth in Ukraine

The international statistics show that the total number of population capable of carrying out business activities does not exceed 7-10%. Based on the preliminary results of the Ukrainian population census, conducted in 2001, the population of Ukraine is 48,416,000 people (express-information from the State Statistics Department #162, dd. May 29th 2002). Therefore the maximum number of businesses in Ukraine (both large and small) is 4,8 mln.

At the National SME Meeting, which was conducted on July 15, 2002 in Kiev, the Minister of Economy reported that the total number of small businesses in Ukraine in 2001 was 1,706,600 (233,600 companies and 1,473,000 individual entrepreneurs).

Both at the National SME Meeting and in various small business surveys the number of small businesses per 1,000 of population is estimated at 4.5...4.8. This number is calculated in the following way: the number of small businesses (legal entities) is divided by the number of the country's population. The significant difference in the number of businesses in Ukraine (4,5) and the European Union (45) per 1,000 people led to the following conclusion: "the number of small businesses in Ukraine is very small and the government should pursue a policy of increasing the number of small businesses". No one ever doubted this conclusion and looked at individual entrepreneurs as one of the most vivid and typical representatives of small businesses. If the number of individual entrepreneurs is included in the number of small businesses, the ratio per 1,000 people goes up to 35.2 %, same as in Poland, France and Germany. In Poland, for example, small businesses include (as of 2000): "state, communal, foreign enterprises; enterprises that are not owned by NGOs and foundations; cooperatives; corporations (joint-stock companies, limited liability companies, etc); and firms owned by natural persons who are engaged in business activity".. [8]

There are several reasons for such understanding of small businesses.

The first reason is merely technological, and auxiliary by nature – it is the problem of the statistics. There is no centralized tracking of the total number of businesses (both corporations and natural persons) in Ukraine. The State Statistics Department keeps record only of legal entities. Information about individual entrepreneurs can be obtained only at the State Tax Administration (tax administration processes mandatory tax reporting submitted by subjects of business activity and monitors the number of people employed by businesses) and in state registration agencies (while the agencies keeps registers of subjects of business activity, they can't even say whether these businesses operate or not).

The second reason is of a systematic nature. Apparently, small business surveys in Ukraine focused only on small enterprises and overlooked entrepreneurs who did create legal entities. Individual entrepreneurs are still perceived as a temporary and therefore unimportant phenomenon, even though this organizational form of business has been fully legal since 1991. All those who used the information – government institutions, NGOs and entrepreneurs – have been satisfied with such an approach to the calculation of number of businesses. At least, the authors of this report are not aware of any public criticism of it. Therefore, we may conclude that in Ukraine small business perception is based on legal entities. Another evidence of the popularity of such an approach are frequent news articles that voice concern over the

underdevelopment of industrial small enterprises and dangers of large concentration of small businesses in trade sector.

Table 1 shows integrated indicators that characterize current stage of small business development in different countries, including individual entrepreneurs (which conforms to requirements of Article 1 of the Law of Ukraine “On State Support for Small Businesses”, dd. October 19, 2000, #2063-III). [2]

INTEGRATED INDICATORS THAT CHARACTERIZE SME DEVELOPMENT IN DIFFERENT COUNTRIES

Country	Number of SMEs (thousands)	Number of SMEs per thousand of population	Employed in SME sector (mln. people)	Share of SMEs in total number of jobs (%)	SME's share in GDP (%)
UK	2630	46	13.6	49	50...53
Germany	2290	37	18.5	46	50...52
Italy	3920	68	16.8	73	57...60
France	1980	35	15.2	54	55...62
EU countries (overall)	15770	45	68	72	63...67
USA	19300	74.2	70.2	54	50...52
Japan	6450	49.6	39.5	78	52...55
Russia	890	6.1	6.5	10	10...11
Ukraine (only corporations)	233.6	4.8	1.72	8 (approximately)	10 (approx.)
Ukraine (all small businesses)	1706.6	35.2	Data not reliable	Data not reliable	Data not available

Note: ‘Data not reliable’ or ‘Data not available’ means that statistics is not available for these indicators. The obligatory SME reporting for statistical purposes may not be regarded as a reliable source of information. Such reporting is more of a burden and an additional cost to small businesses. It would be more effective to collect statistics on the SME sector through sampling studies and interpolative calculations. In this regard we must note that on April 30th 2002 the State Statistics Committee of Ukraine issued Order #178 “On Approval of the Questionnaire Form for Enterprises Based on the State Statistics Reporting Form N1 ‘Business (small): Report on the Main Performance Indicators of Small Enterprises in the First Half-Year of 2002’”. According to Article 2 of the Order “the report...is filed by small enterprises of all types... that have been selected in accordance with methodical principles of the sampling method”. Thus, we may say that in 2002 the Ukrainian government started to apply forecasting assessment methods to the SME sector. This should provide reliable statistical information about the sector and make the collection of such information not so economically burdensome on small businesses.

Conclusion: Thus, we may say that the actual number of SMEs per one thousand of population in Ukraine corresponds to the European average. In other words, the Ukrainian SME sector has been successfully formed.

1.2. We should note that small business is not homogeneous by its structure. The following categories of small businesses may be singled out based on the complex criteria that includes both social significance and economic capacity [5,6]:

- **small business vs. poverty:** these are predominantly individual entrepreneurs that sell various products on the markets or provide basic consumer services. The main characteristic of this category is that it is represented by self-employed individuals who are engaged in business only to make a living, without any ambitions for further growth.
- **stable small businesses:** These are mostly enterprises involved in trade, restaurant/public catering business, manufacturing or service industry. They enjoy relatively low yet stable incomes and own certain assets, however they, too, rarely show interest in further growth and expansion.
- **small business ‘tigers’:** Small businesses, the sizes of which fall under the definition of a small business, that grow very rapidly and have big ambitions. As a rule, these companies look for and have their own ‘know-hows’, introduce the most modern management and quality control systems, and serve as the best foundation for innovations.

Different categories of the SME sector have different characteristics and different social and economic capacity (‘value for the society’). The largest category – ‘business vs. poverty’ has a great social value. At the same time, it is the category that is most vulnerable and sensitive to changes in economic, political and social environment. That is why it is this particular category that needs support of the state, namely in the form of a stable legal environment and simple and transparent regulations. As for the second category – stable small businesses – it also needs transparent and stable regulations. However, small businesses in this category face a larger number of regulations when conducting their activities. On the other hand, they have the potential to attract significant credit resources, which will make them even more stable. Small businesses in the third category – the ‘tigers’ – are the most promising to the economic development of entrepreneurship, although they have a relatively small share in the total number of small enterprises. Beside friendly tax and regulatory policies these small businesses also need consistent innovation and investment policies.

Conclusion: Overall, government policy for each category of small businesses must have certain individual characteristics but be based on the same ideology of the liberal market development.

1.3. Several viewpoints with regard to the above mentioned statement are common in Ukraine.

Mere use of the term ‘market economy’ in government documents does not necessarily mean that the government policy truly incorporates market reforms. This can be illustrated by a lot of examples, including current overregulation of economy,

widespread bribery, high level of government's interference in business relations, and others.

Government policy, which aims primarily to protect citizens, always has certain flaws and risks. As long as the main focus is on the mechanisms of direct protection of citizens, the government will continue to cultivate infantilism in people and reinforce the inclination of the state power to absolutism. Under the slogans of 'consumer protection' or 'elimination of proprietary inequality', the government easily shift from regulating the saturation level on the high-tech appliances market (TV sets, cars, etc) to regulating quantitative and qualitative consumption of food products and use of people's free time. In other words, such risks increase when the government declares a policy based on the direct protection of citizens. It is obvious that the level of protection of each individual citizen, due to the flaws of the management system and motivation of its particular elements, will never be realized while the cost of such policy's administration tends to increase. This is irrefutably evident from our history.

An effective alternative would be to direct the government policy toward the creation of a system that would enable citizens to protect their own rights. Under such system, for example, a citizen must take a consumer right violation complaint to court and prove the subject of the dispute. Such a system makes citizens more responsible and less passive.

Conclusion: it is the first model that has been declared in Ukraine – government policy as an instrument for direct protection of citizens. As a result, the government not only interferes in practically all forms of social relations, and does so completely lawfully, but it also uses the same principle for building other policies, such as SME development policy.

- 1.4. SME development ideology in Ukraine inclines towards the thoroughly-regulated state model. Lack of government's resources and difficult social and economic situation in the country serve as a counterbalance to this ideology. That is why it is not by accident that the following thought emerged in 1998: **“the minimal expectations of the Ukrainian government with regard to the proceeds to the budget significantly exceed the maximum capacity of economy”**. In this situation the Ukrainian government's SME policy resembles a complicated and active dance during which the dancer always stays in one place.

The main reasons for this are the distinguishing characteristics of small business:

Pros and cons of small business for the Ukrainian government system

Advantages	Disadvantages
Creation of new jobs without cost to the budget.	Economic sustainability of individuals which lessens their dependency on the state.
Decrease of social tension in the society.	Self-respect of individuals (which is based on their independence).
Absorption of excessive workforce on the labor market.	Strengthening of the civil society principles.

Proceeds to the budget (on all levels).	Demands for transparency in the government system.
Development of economy, which to a certain extent derives from the social importance of small business.	Demands for higher level of government's accountability.

Conclusion: For the existing government system, the advantages of the SME sector (table 2) are about of the same weight as the disadvantages, which motivates the government to maintain ‘status quo’ with the sector – neither to develop, nor to destroy it.

1.5 As a continuation of the aforementioned ideology (the ‘status quo ideology’), there is **an ongoing dispute about the place and role of small business – whether small business has an independent social and economic function, or whether it should develop as a large industry’s satellite (the satellite development model).**

What are the possible consequences in these cases?

First of all, we must mention that the primary reason for this dispute is the special attitude of people in ex-USSR toward manufacturing types of businesses. From the economic perspective, added value is created both when manufacturing a certain product or when providing a service. If we talk about products for a regular consumer, under market economy the share of production in the final price of such product usually constitutes 30 to 50 %. That’s why manufacturing and services are two equal elements of a national economy. We must specify here that for a national economy a healthy production means production of only those products that find their consumers, as opposed to products that were manufactured under the Soviet administrative economy.

However, in Ukraine (as well as in other former USSR republics) many people believe that the small businesses’ focus on services is ineffective and wrong. This thought is confirmed by frequently-heard comments like “The problem lies in the structure of the Ukrainian SME sector, in its focus on intermediary operations, its disunity and almost complete absence of cooperation with large enterprises”, or “One can not be satisfied with the structure of small business sector, which always inclines toward intermediary services’.

The danger of such statements lies in the desire of certain forces to forcefully combine small business development with the development of large industries. Small business always acquires special importance for the country in a time of crisis, due to its independence from government subsidies, high dynamics of new jobs creation and absorption of excessive workforce. The independence and self-sufficiency of small business sector allows the government and large enterprises (including those that provide jobs to the majority of population in a particular area) implement economic and organizational reforms with minimal social tensions. Instead, when stringent economic bond ties large and small enterprises (the latter, as a rule, focus on isolated production stages) small businesses become the first victims of economic or social crises, and the social situation in the country deteriorates very rapidly if large enterprises are not economically powerful enough (as they are not in Ukraine today).

The danger of ideology that regards small businesses merely as satellites of large enterprises is that it entirely denies the social function of small businesses that plays the most important role during economic reforms.

This dispute also demonstrates the reluctance of certain forces to give the SME sector a chance to develop. They are afraid of the growing disadvantages for the existing system (see table 2) – the economic independence of businesses lessens their dependency on the government; such economic independence also boosts small businesses' self-confidence, which lessens their dependency on government agencies even more; this, in turn, leads to the strengthening of civil society principles and growing demands for transparency and greater accountability of government agencies.

The supporters of satellite SME development model use the following arguments: “the disagreement is becoming very obvious between objectively high economic, social and political importance of the SME sector, and poor viability of its individual subjects” [1].

What is the danger of such statement? First of all, its authors intentionally or non-intentionally attribute SME sector's strong points to its weaknesses. The power of the SME sector lies in its massive character, in renewal of its elements and competition between these elements. An individual small business never competes with large enterprises (economy of scale) but continuously competes with businesses of the same size. On the one hand, this provides motivation for the development that benefits the consumer (including development of the technological component, which can be accepted by large enterprises as well, if it is successful). On the other hand, bankruptcy of one element of the SME sector doesn't affect the entire sector. However, this is true only if the government's policy is directed at increasing the total size of the SME sector, which is usually achieved by making markets easy to enter and exit, keeping business regulations simple, etc. The closest analogy would be the comparison of ‘large businesses – medium businesses – small businesses’ pyramid with the nature's biological mass pyramid ‘large animals – medium animals – insects’, which we all know well from biology classes in secondary school. Secondly, the main danger lies in the fact that sustaining an individual business's viability requires certain government resources (either resources for bankruptcy control and prevention, or resources for direct support and readjustment). In any case this eliminates positive aspects of small business for the society and replaces them with a tendency towards ineffective use of government resources under the slogan of ‘protection of a subject of economy’. In other words, to agree with the idea that viability of individual businesses impact the entire sector is to agree with the government's increasing interference into the work of each individual small enterprise. As we mentioned above, such interference has no economic sense as it only burdens the controlling government agencies with costs, discourages SME's growth and thus minimizes the entire positive social role of the sector.

Another argument used by supporters of the satellite SME development model is based on the claim that SME sector may present potential danger to the national economy [1]: “An additional element that requires specialized regulation of the SME sector is a series of potential threats to national security that may result from small enterprises' activities. In particular:

- a threat to financial security of the country through uncontrolled outflows of financial resources abroad, increased cash circulation in the country, conversion of non-cash funds into cash, etc.
- ‘shadow’ operations, hiding profits, growth of ‘shadow employment’, ties with criminal groups, money laundering, etc;
- waste of rare resources and their inefficient or improper use, wasteful use resources that belong to the state or to enterprises;
- noncompliance with standards, sanitary norms, other regulatory requirements to consumer products due to poor production processes, lack of quality control, attempt to reduce the price of the product, etc;
- environmental threats related to the production processes, warehousing or use of the manufactured products;
- structural deformation of human potential, distraction of qualified and competent labor, noncompliance with work safety requirements that leads to human potential losses in the country.

Without arguing about the threat such actions may present for the national security, we must note the following: none of the threats listed above is characteristic of small businesses alone. The above list fully applies to large businesses and industries, as well. Basically, it is a series of system risks that appear primarily as a result of ineffective government policy concerning national economy regulations. Blaming all the risks on small businesses alone is the same as accusing manufactures of hammers of boosting the crime rate simply because several criminals have used hammers as a murder weapon.

Conclusion: Ukraine is yet to recognize the fact that the small business sector has an independent importance for social and economic growth of the country, and that a well-developed sector reduces risks for national security (in particular, it minimizes the risks of social conflicts and helps create a middle-class that is interested in stability).

2. STAGES OF SME POLICY DEVELOPMENT: RETROSPECTIVE

At various stages of our country’s development the government’s SME policy was built differently. However, over the last 10 years of independence, the Ukrainian government managed to create and implement some programs that aimed to develop business in general and small business in particular.

2.1. Stage 1: The real formation of the government SME policy in Ukraine began in 1991, after the Law of Ukraine “On Entrepreneurship” was adopted on February 7th, 1991 by the 3rd session of Verkhovna Rada, and after the State Committee for Small Business Support was created in May 1991.

With the purpose of implementation of the government’s business support policy (which also included small businesses), in March 1993 the Cabinet of Ministers approved the State Program for Entrepreneurship Support in Ukraine. It was regarded as an element in a series of measures directed at the development of market relations in Ukraine, coping with the economic crisis in the country and Ukraine’s inclusion

into the world's trade relations. The main activities of the government to promote small business development were carried out in line with the Comprehensive Plan for implementation of the above mentioned program (although such comprehensive plans were adopted in 1993 and 1994, the plan for 1995/1996 was never approved).

The Program in 1993 outlined the following main objectives:

- implementation of state policy for support and protection of entrepreneurship;
- establishment of legal, organizational and economic conditions for its development; and
- formation of a mechanism for government's regulation and coordination of business.

The Program of 1993 was based on the understanding of business that was common in Ukraine at that time: government agencies tried to regulate and coordinate business activities as they had practiced it under the administrative economy.

Nevertheless, the Program of 1993 has played its role by stimulating the development and adoption of new laws to foster entrepreneurship development.

2.2. Stage 2 of the government SME support policy began in 1996, when the Cabinet of Ministers approved the Concept for Small Business Development Policy (April 1996), the freedom of enterprise was fixed in the Constitution (June 28, 1996) and the Cabinet of Ministers approved the Small Business Development Program for 1997/1998 (January 1997).

The Concept for Small Business Development Policy, which was approved by the Cabinet of Ministers' Decree #404 on April 3rd, 1996, particularly stressed that the government small business development policy is an integral part of the overall social and economic policy of the Ukrainian government and that it establishes the core principles, directions and forms of economic and administrative influence.

The Small Business Development Program for 1997/1998, developed by the Ministry of Economy in line with the Concept and approved by the Cabinet of Ministers' Decree # 86 on January 29th 1997, became another instrument for small business support and for fixing numerous problems that were hampering small business growth.

The Program for 1997 established the following objective: to ensure an ongoing growth of small business as an integral part of market economy and a crucial factor for the creation of new jobs. It was very important that the program recognized the key social significance of small businesses, particularly a rapid growth of new jobs that doesn't require any government funding.

The Program of 1997 seemed to recognize the fact that the government policy should be based on economic expediency, that small enterprises must rely first of all on themselves, and that the government's role is merely to create conditions for preservation of competition while giving small businesses 'the most favored' status.

The conceptual part of the 1997 program, which outlines the main directions for the program's implementation, is quite well-balanced despite certain elements of paternalism. Government agencies did not loose their wish to centralize and allot certain support flows, which was especially apparent in the field of international financial assistance distribution.

The 1997 program failed to play the role of a consolidating mechanism that would unite efforts of various government agencies to implement the small business development policy.

- 2.3. **Stage 3 of the government small business support policy began in 1998** when the State Committee for Entrepreneurship was created. This stage had the following main characteristics: recognition of the need to reduce government's interference in business activities, rejection of the paternalism on the part of the government, formation of business friendly environment by eliminating administrative barriers and bureaucracy.

The State Committee for Entrepreneurship became a special institution among other government agencies. In fact, it became a representative of the business sector' interests and the platform for a new policy of reduced government's interference in business activities. This special role of the Committee was outlined in the Presidential Executive Orders #79/98 dd. February 3, 1998 "On elimination of barriers that hamper entrepreneurship development" and #89/2000 dd. January 22, 2000 "On introduction of a unified state regulatory policy in the field of entrepreneurship".

Section 'Examples of effective decisions' of this report talks more about the regulatory policy implementation.

At the same time the State Committee on Entrepreneurship worked to create mechanisms for collaboration with business community. An important step in this work was creation of the institute of "Authorized Representatives on Entrepreneurship Development". Such representatives became a bridge between entrepreneurs and local authorities. The function of authorized representatives is to represent interests of entrepreneurs and to collect feedback from business community.

Public hearings on draft regulatory acts became another mechanism in the organization of a systematic collaboration. They were legally introduced by the Presidential Executive Order "On Introduction of a Unified State Regulatory Policy in the Field of Entrepreneurship".

Collaboration between the sector and authorities was facilitated by the following advisory institutions:

- on the regional level – public boards chaired by Authorized Representatives and coordination councils for entrepreneurship development under local governments;
- on the national level – Public Board under the State Committee for Entrepreneurship, Council of Organizations of Entrepreneurs under the State

Committee for Economic Development, and Entrepreneurs' Council under the Cabinet of Ministers.

As seen from the list, a wide range of instruments has been created for building up the collaboration between small business sector and authorities. However, the effectiveness of such instruments depends on one's willingness to use them.

For the effective work of such mechanisms the will of the State Committee for Entrepreneurship is not enough. There is a need for all government agencies to participate in this work. Experts say that as of today, neither local administrations, nor the Cabinet of Ministers, nor do other national government institutions seem to be interested in using the above mentioned mechanisms.

- 2.4. **The further development of the SME policy, and probably the beginning of its new stage** began with the adoption of the law "On State Support to Small Businesses" (#2063-III, dd. October 19, 2000) and the law "On the National Small Business Support Program" (#2157-III, dd. December 21, 2000).

The law "On State Support to Small Businesses" was the first to establish "legal grounds for state support to small businesses of all types of ownership, aimed at the fastest possible settlement of the economic crisis and creation of necessary conditions for implementation of market reforms in Ukraine". In other words, small businesses were recognized as a key factor for the implementation of market reforms in Ukraine. The law also outlined the role and place of small business development programs. The law stated that "the National Small Business Support Program is a series of activities aimed at implementation of state SME support policy".

- 2.4.1. **The National Program was designed as a consolidating mechanism for policy implementation to include not only national government agencies but also local authorities, organizations of entrepreneurs, business-centers, business-incubators, consulting and leasing firms, etc. It is important that based on these principles the Program, as well as the SME support policy, can become truly nation-wide.**

The law "On the State Support to Small Businesses" stipulates that "the Cabinet of Ministers annually, together with the draft law on the state budget of Ukraine, submits to Verkhovna Rada information about implementation of the National Small Business Support Program with the proposal for allocation of funds in the next year's budget (specifying the sources of funding) for carrying out activities aimed at the Program implementation. The selection of the Small Business Support Program implementation projects shall be conducted on a competitive basis. The bidding and selection procedure shall be approved by the Cabinet of Ministers of Ukraine."

The Law of Ukraine "On the National Small Business Support Program" consists of 2 parts.

The first part – the conceptual part – determines the state of small business development in the country at the beginning of the National Program implementation (hereinafter – the Program), and sets the Program's goal: "to create proper conditions

for realization of the Constitutional right to enterprise, and to improve the wellbeing of the Ukrainian citizens by encouraging them to go into business”. It also describes the objectives and **the main directions for the Program’s implementation:**

- **improvement of laws and regulations that apply to entrepreneurial activities;**
- **formation of the uniform state regulatory policy with regard to entrepreneurial activities;**
- **enhancement of financial, loan and investment support to small businesses;**
- **facilitation of small business infrastructure development;**
- **implementation of regional small business support policy.**

The important thing was that the role of regulatory policy was legally established and that the law made the following statement: “the measures to implement state regulatory policy are aimed at ensuring the consistency and coordination of all actions concerning the development and implementation of new regulatory acts, and incorporation into such acts comments of the general public. All of this is aimed at achieving the optimum level of state regulation of business”.

Unlike previous programs, the National Small Business Support Program attributes special significance to the infrastructure of small business development, as well as to coordination of efforts in regional politics.

2.4.2. The second part – **Activities of the National Program – is the most dynamic part of the program. These activities were designed to fill the established directions for small business development with real content.** This part describes the instruments that the government uses to achieve the Program’s goals. The fact that the Activities are approved annually and that the Cabinet of Ministers of Ukraine must report to Verkhovna Rada on the last year’s activities creates an opportunity for all organizations that are concerned with small business development to improve the efficiency and effectiveness of the Activities.

However, the evaluation of Activities in 2001 and preliminary data on 2002 indicate that so far no instruments have been found to influence small business development in a real, positive and significant way. There are several reasons for that:

First of all, despite declaration of state support, neither in 2001 nor in 2002 the state budget allocated any funds for financing of the program activities (based on the results of the half-year). At the same time this is an evidence of the understanding and fulfilling of the government small business policy by the authorities themselves.

Secondly, the activities for 2001 and 2002 were not made concrete enough. That’s why even certain steps that were made to implement these activities did not bring any positive results. Verkhovna Rada considered and adopted draft laws that couldn’t possible make a significant impact on the environment. Meanwhile legislators were reluctant to support those draft laws that could solve major issues.

2.4.3. Improving legal framework of entrepreneurial activities

No significant positive changes have been made in the SME's legal framework except for the adoption of some regulations on minor issues. Several important draft laws were developed and submitted to the Cabinet of Ministers and Verkhovna Rada (on regulatory policy, regulation of inspections of businesses, NGOs, etc.) but due to certain reasons so far these draft laws found no support. On the contrary, the Cabinet of Ministers of Ukraine adopted a series of resolutions (on methodology for applying indirect taxation methods, on the list of documents and products subject to mandatory protection by holograms, etc.) that have a negative impact on business development. The Ukrainian government also drafted and submitted for consideration of Verkhovna Rada a series of draft laws on taxation, which attempt to reform the simplified taxation methods for small businesses. Adoption of these draft laws can leave little if any incentives for small businesses.

This proves that there is no systematic approach to implementing the policy of the state, and various central executive authorities, as well as the Secretariat of the Cabinet of Ministers, disregard the existing SME support policy.

2.4.4. Formation of the unified regulatory policy in the area of entrepreneurship

For the second successive year measures and activities in this area are formulated very ambiguously. Actually they limit to the list of functions to be performed by the State Committee on Entrepreneurship.

Therefore, on the one hand, we can recognize certain achievements in the policy implementation: public hearings of draft regulations are held, inefficient regulations are revised, deregulation resolutions on elimination of barriers that hamper business development have been adopted (17 such resolutions were adopted back in 2001).

On the other hand, the results of public hearings are mostly ignored by state authorities, deregulation process was practically suspended during the last year (appeals of state authorities against resolutions of the State Committee on Entrepreneurship are considered by the Governmental Committee for Economic Development; due to the lack of political will this mechanism offers advantages for the administrative system to block progressive resolutions), and state authorities volunteered to revise only the outdated “ineffective” regulations they no longer need.

This significantly undermined the effectiveness of regulatory policy and **proved once again that political will of state authorities on all levels is required to put in place a really effective policy mechanism.** Unfortunately, this political will in Ukraine is inconsistent and contradictory.

2.4.5. Enhancing financial, credit, and investment support of small business

Traditionally there is no significant progress in this area. Lack of funding for the National Program did not allow undertaking any specific measures. Credit Guarantee Institution actually does not perform the functions it was created for and multiplier mechanism for partial guarantee of loans failed to become an effective instrument of

the SME development policy. Business support funds operate as organizers of certain events rather than credit and financial institutions. Access of small business to credit resources remains extremely unsatisfactory and this is acknowledged on all levels to be a real problem for small business development. However, the state did little, if anything at all, to actually improve the situation.

The only positive example in this area is the development of Micro-Finance Bank that actively launched its operations and is currently developing the network of its regional offices. The state also offered no support to some commercial banks that initiated small business crediting programs and pawn-shop lending. However, these examples demonstrate the work of true market mechanisms that develop aside of the declared public policy and, more often than not, despite it. Their enhanced activity is influenced in the first place by the general status of economy and revival of economic activity on a macro level.

Non-bank lending institutions, even if they operate (like, for example, credit unions) still can hardly claim to be of significant importance as the sources of funding for small businesses. However, the need for non-banking lending institutions still persists because bank lending sector is heavily regulated (the Micro-Finance Bank's Director emphasized this during the National SME Meeting held on July 15, 2002) and judging by the government monetary policy this regulation can become even more severe.

Therefore, we can conclude the following: the development of credit and financial mechanisms does not meet the needs of the SME sector.

2.4.6. Promoting the creation of infrastructure for small business development

Infrastructure for small business growth also developed due to recent economic revival that contributed to the increased solvency of some businesses. These solvent businesses "buy" services from business centers, consulting and information institutions, etc. Actually, two factors – active international technical assistance and improved solvency of certain small businesses – facilitated the infrastructure development.

However, we cannot say that infrastructure subjects face no problems. They are also businesses, and therefore face all administrative barriers existing in Ukraine: corruption, protectionism, etc. In fact, effective instruments exist only on local levels, where there is a strong will to develop this infrastructure.

Currently, one of such instruments are preferential rates/tariffs on lease of premises, or sometimes even free allocation of premises for certain types of business activity locally perceived to be of top priority.

National Program for 2002 makes a special emphasis on educational services and outlines important tasks to be achieved in this area, including creation of a distance learning system, inquiry and information networks, etc. These are, of course, important steps but it is too early to judge to what extent they will be implemented.

2.4.7. Implementing regional SME support policy

This area for implementation of the National Program is a political one, since it rather performs the function of a “milestone” for local authorities regarding small business development.

Regional programs for promotion of small business development were adopted on the local level and funded from regional budgets. The largest success in 2001 was achieved due to the development of institutional cooperation between entrepreneurs’ associations and local authorities. Public Collegiums of the State Committee on Entrepreneurship operate in all Ukrainian regions and over 600 coordination boards on business development function on all government levels and include both government officials and business community representatives. It is not always that these coordination boards achieve good results. Very often important decisions are made without prior consultations with the boards. Nevertheless, the institutional instrument has been created and its enhanced effectiveness depends on the activity of business community.

Regional policy area traditionally includes specific sector programs, such as the employment fund program, which in 2001 allocated UAH 25 mln for one-time allowances to unemployed to start their own businesses. Business plan competition among young business owners was also implemented.

However, despite the fact that local authorities began to work more actively to promote business growth, essential instruments that exist in other countries are still non-existent or remain idle in Ukraine. First of all this refers to the reform of local administrations and overcoming of administrative barriers.

So far, due to ambiguity of measures, lack of funding and lack of ongoing control over the Program’s implementation, the National Program for Small Business Development does not play the role of a consolidating mechanism for the implementation of SME support policy.

3. EXAMPLES OF EFFECTIVE DECISIONS

Analysis of statistical data and analytical materials on small business development clearly proves that the most significant progress was achieved in reforming the legal framework of entrepreneurship.

3.1. Early in 1998, key legislative amendments were adopted that introduced three new methods of simplified taxation in Ukraine: fixed tax (introduced by the Law of Ukraine “On Amendments to the Decree of the Cabinet of Minister of Ukraine “On Profit Tax from Citizens” dated 13.02.98), special trade patent (introduced by the Law of Ukraine “On Amendments to the Law of Ukraine “On Patenting Certain Types of Business Activity” dated 10.02.98.), and single tax (introduced by the Decree of the President of Ukraine “On Simplified System for Taxation, Accounting, and Reporting of Small Business Entities” dated 03.07.98., #727).

Implementation of these simplified taxation methods, which took place under the pressure of business community, had the most significant impact on the SME growth (in terms of their number) observed since the beginning of 1998.

Major achievement of simplified taxation methods are as follows:

- **Simplicity and transparency of tax regulations;**
- **Simplicity of determining the taxation basis;**
- **Minimization of accounting procedures, which are easy to understand even for a layman;**
- **Simplicity of control/supervision procedures.**

Each of these methods enables respective subjects of business activity **to voluntarily choose** the appropriated scheme: taxation pursuant to the general system or under the simplified method. It is worth noting that simplified taxation does not have the nature of taxation privilege because tax liability is determined pursuant to the assessment principle.

Ideological foundation of the simplified taxation methods is as follows:

The potential of the SME sector as of a social mechanism for absorption of excessive labor force and economic factor of state's security can materialize and come into reality only if a large number of small businesses operate in the country. In this case the economy of scale comes into force where the lifecycle of one sector element becomes practically of no significance. On the contrary – continuous renewal of constituent elements (that is small businesses) plays an important role in securing sector's transparency and fast reaction on external changes. This principle relies on the state's securing simple procedures for market entry and exit, simple business regulations, as well as simple control and supervision procedures, which, in turn, is explained by the necessity to involve in the SME sector a large number of people who have no specialized training. If state ideology provides for the development of the national small business sector, the rules should be as simple as possible, easy to understand for any secondary school graduate. This would guarantee that state regulation of the SME sector does not discourage citizens from trying themselves as business owners, but on the contrary stimulates and provides incentive for such attempts. Major area for applying the simplified taxation ideology is the burdensome system of collecting taxes and mandatory payments (not even their amount and number, but their administration related expenses incurred by businesses).

Therefore, the most important factors that promoted the mass use of simplified taxation methods by small businesses are as follows: maximum inclusion of all mandatory payments and taxes, and simple definition of the taxation framework – percentage from sales or fixed amount depending on the type of business activity. For example, social payments, which are burdensome in terms of their administration and which are controlled by 4 different authorities, are included in the single tax (or fixed tax, or trade patent). The VAT, in its economic sense, is also included in a fixed tax and fixed tax payers are free to choose either a fixed tax totaling 10% from sales (including VAT), or 6% flat tax plus VAT payable on general terms. This creates a flexible and clear system for small businesses characterized by simple administration and, accordingly, practical absence of groundless conflicts with controlling authorities, reduced bribes, and stimulates businesses towards fully legitimate operations.

First large scale protests against harsh fiscal administration system, which resulted in corruption and bribes, dates back to the end of 1997 and early 1998. These moves of

entrepreneurs resulted in adoption of amendment to the Decree of the Cabinet of Ministers of Ukraine “On Income Tax of Citizens”, which actually introduced the fixed tax. At the same time, city mayors who had good understanding of instruments for business development and replenishment of local budgets, lobbied for the introduction of a special patent, but lack of general large scale campaign limited the application of this method only to the status of an experiment conducted within certain territories. Following the introduction of the fixed tax, budget proceeds from entrepreneurs – market vendors increased fourfold. Business owners were also happy, since the introduction of simplified taxation methods significantly reduced bribes. This inspired political will in Ukraine and in 1998 the Decree of the President “On Simplified System for Taxation, Accounting and Reporting of Small Businesses” was adopted.

We can therefore conclude that it was business community who initiated these tax innovations (i.e. simplified taxation methods) in Ukraine.

3.2. This time was also marked by the beginning of shaping legislative framework for regulatory policy as the instrument called to foster business development. The following Decrees of the President of Ukraine were drafted and adopted: “On Elimination of Barriers Hampering Business Development” #79/98 dated 03.02.98., “On State Support to Small Businesses” #456/98 dated 12.05.98., “On Certain Measures for Deregulation of Business Activity” #817/98 dated 23.07.98, and “On Introduction of the Unified State Regulatory Policy in the Area of Entrepreneurship” #89/2000, dated 22.01.2000.

These Decrees were the first to declare and acknowledge the fact of excessive state interference with business activities and state the necessity for the decrease of such interference. In other words, they outlined the course for liberalization of business activity.

These Decrees declared principles, which, if complied with by state authorities, are expected to result in reduced regulatory barriers.

These principles include:

- Expediency, sufficiency, and compliance of regulations with market relations requirements;
- Effectiveness and positive economic and social results of regulations’ implementation;
- Systematic nature and consistency of actions regarding development, adoption and enforcement/implementation of regulations;
- Publicity and transparency during the preparation of important regulations which have a significant impact on market environment, rights and interests of entrepreneurs, as well as public discussion of such draft regulations;
- Keeping businesses timely informed of issued or adopted regulations.

To-date, regulatory policy in Ukraine can claim certain achievements.

First, institutional foundation has been created to implement the unified regulatory policy in the area of entrepreneurship. The system of procedures for preparation and implementation of regulations has been created. This system is based on principles of publicity and feasibility of arguments. The idea of self-controlling governmental authority (the State Committee on Entrepreneurship) is currently being fulfilled.

Second, possibilities have been created for a public dialogue between state authorities and business community regarding state resolutions in the area of entrepreneurship.

Third, there is evident positive dynamics in preparation and implementation of regulations, as well as in the area of deregulation.

The analysis of dynamics proves that on early stages of applying regulatory policy the administrative system was shocked and gave in to the pressure towards liberalization. The political will also played an important role as in the Ukrainian government a Vice Prime Minister was responsible for promotion of regulatory policy. However, with time the system developed bureaucratic ways to impede liberal policy. For instance, the analysis of regulatory impact, which, pursuant to the Resolution of the Cabinet of Ministers of Ukraine #1182 dated 31.07.2000 is mandatory for all draft regulations, is performed as a mere formality. In reality, no one tries to find possible alternatives to the proposed regulation or assess entrepreneur's expenses related to the fulfillment of regulation. A piece of paper, proudly called regulatory impact analysis, in most cases cannot be characterized as the analysis.

The administrative system has developed the immunity against deregulation. Any resolution of the State Committee on Entrepreneurship is appealed against by respective state authority to the Governmental Committee on Economic Development whose members – ministers – are typical representatives of the administrative system. Over the last years a complete lack of political has led to the situation where resolutions of the State Committee on Entrepreneurship never come into force. .

The experience of regulatory policy implementation proves that the administrative system is capable of blocking liberal changes and only political will for the reform of the administrative system itself and liberalization of regulatory field can significantly improve the situation.

4. CONTRADICTION WITH OTHER POLICIES

4.1. There is no correlation between social policy and SME support policy. In particular, the introduction of new social insurance dues and reform of already existing social payments do not take into account a significant portion of payers – those who use simplified taxation methods.

What does this lead to? To legal nonsense: dual taxation by social payments. Allocations to respective social funds are deducted from the single tax paid by a business entity. However, de jure this legal entity has to make payments to these same funds again. This also results in a lot of papers to be prepared and submitted pursuant to accounting and reporting requirements. For example, paying, in addition to a single tax, small dues to the pension fund, a business owner currently has to submit monthly reports to the pension fund. This adds unnecessary work to the pension fund and takes

up a considerable time of an entrepreneur who, instead of engaging in business operations, has to deal with accounting and reports.

Social protection for employees is really important in any area, but it should be built by taking into account and preserving the advantages offered by the simplified taxation methods – simplicity and minimization of reporting and accounting. Currently, all social payments can be easily included in the single tax (fixed tax, or trade patent) to avoid any extra unnecessary work. Various social funds that are built on a solidary principle and actually have all features of a tax (or dues) contribute neither towards the increase of legitimate salary, no towards the creation of new legitimate jobs.

Until employees themselves demand the personification of payments (and this is possible only under condition of accumulating insurance funds), employers-small business owners will have no incentive to “show” actual salary.

Currently, this inconsistency of social legislative provisions with regulations governing simplified taxation methods threatens to ruin the major achievement of small business development policy – simplified reporting and accounting system.

4.2. General fiscal policy of the state permanently conflicts with the SME development policy and, namely, with simplified taxation methods.

Lack of reforms within the general taxation system, its burdensome nature for all businesses result in large enterprises trying (in different ways) to optimize their taxation by using, for example, simplified taxation methods and entrepreneurs-natural persons. Opponents of simplified taxation (mostly representatives of tax authorities and the Ministry of Finance) use these examples to argue against the simplified taxation system. However, it is worth noting, that as long as there is fiscal pressure on all business entities, including (most importantly) on salary payable to employees, there will be motives to misuse the opportunities offered by the simplified taxation system. But placing liability for budget problems on small businesses can hardly be an intelligible and effective solution of the problem, especially when millions of grivna worth of debts are written off and by far not from small businesses, when there are so called “conversion centers”, misuse of large budget funds, and when the amount of privileges equals to the amount of proceeds to the budget. Such attempts to shift the entire burden of accounting and reporting on small businesses in order to reduce abuse and misuse opportunities can result in de-legalization of many small businesses, which will find it much more profitable to operate within the “shadow sector” and pay bribes instead of taxes.

It should be also pointed out that a large number of businesses (without their break down by impact on fiscal system) create a heavy burden on controlling authorities, since control and supervision procedure (not to be confused with the scope of control) practically does not depend on the size of business. This is to say that the same degree of control and supervision over small and large businesses is much more expensive for the state then diversifying the extent of control depending on the size of business entity.

However, despite political declarations of the President of Ukraine and political leaders of the country, draft laws prepared by the Government of Ukraine in 2001-2002 clearly tend towards narrowing the area for application of simplified taxation methods and increasing the scope of accounting and reporting for businesses that use the simplified taxation methods. This tendency reflects actual impact of fiscal authorities on the policy of the state. These fiscal authorities are active players on the political scene and, unfortunately, their interests are opposite to promoting small business development.

4.3. There are significant contradictions between the consumer protection policy (through the system of technical regulation) and SME development policy.

Consumer protection is one of the tasks assigned to technical regulation system in Ukraine. The principle of preventive control is applied to fulfill this task, which results in excessive regulation and reduplication of both functions and objects of control. This system imposes an especially heavy burden on small businesses. Excessively expanded list of products subject to mandatory certification hampers the development of manufacturing businesses, and inspections regarding the presence of compliance/quality certificates for the products sold at retail market places has recently (by its burdensome nature) replaced fiscal control alleviated after the introduction of the simplified taxation system. Certificate related inspections are conducted by tax police, department for prevention of economic crimes, consumer protection agencies and certification authorities. This transformed into a system for forcing businesses to give bribes and ultimately (instead of decreasing) increases the number of poor quality and dangerous products on consumer market. This burdensome system creates prerequisites for “shadow products’ turnover”. Business owners say: “We have to pay bribes anyway, so it’s much cheaper to sell illegal products”. Despite recent legislative efforts (a series of new laws were adopted in the area of technical regulation, which introduced voluntary declaration of compliance by the producer) Ukraine still fails to civilize technical regulation system, minimize preventive control, and introduce modern mechanisms of liability for committed violation of technical regulation provisions. This is a very illustrative example of the administrative system’s ability to selectively implement laws (or their separate provisions) only when they go in line with bureaucratic interests.

4.4. Effective implementation of small business development policy is directly related to the administrative system reform.

It is the unreformed administrative system that creates all major barriers today, as it is still based on the administrative method of economy regulation. This system and its individual players (officials) are motivated to directly interfere with operations of independent businesses. But this is next to impossible to do with numerous small businesses, where each independent entity has little impact on social and economic environment, but overall impact of the whole sector is significant.

This divaricated system of independent businesses requires other impact instruments that current administrative system does not have. Therefore, separate constituent elements of the administrative system consider small businesses as their patrimony. Currently the administrative system is both “the roof”, which replaces legitimate

mechanisms for protection of property rights, and implicit but important participant in regulation and distribution of revenues generated by small businesses.

This is achieved through the following:

- Obtrusion of administrative services, which are not obligatory and unnecessary for business owners; this is a “legitimate” way to take away a share of profits (not into the budget);
- Interference (through inspections and permit-issuing) with the operations of “other’s” businesses and protection of “friendly” enterprises; this is the abuse of power to change competitive environment;
- Forcing business owners to bribe officials; this allows business owners to avoid artificial barriers created by the administrative system (bribes during inspections, issuance of licenses, receipt of permits);
- Requesting voluntary contributions to “pocket” charity funds.

Thus, apart from the budget, there is an alternative system for satisfying material requirements of administrative authorities. But this opaque, unpredictable system that has no mechanisms for protection of those who pay “the alternative tax” in the form of bribes creates false motivation for business owners. This situation promotes the growth of shadow sector: its easier and cheaper, one can do with bribes only without making any legal payments.

We can state for sure that Ukraine will not see a favorable environment for small business development unless a drastic reform of the administrative system is implemented, motivation of state officials, their functions and possibility to interfere with operations of independent businesses changed, and personal accountability for such interference increased.

5. PROCEDURAL PECULIARITIES OF SMALL BUSINESS DEVELOPMENT POLICY

Despite the presence of regulatory policy procedures that refer to specific regulations (namely, necessity for their substantiation, analysis of possible alternative options, regulatory impact analysis, follow-up analysis of regulation’s effectiveness) these procedures are not applied to the policy as a whole.

Policy formation, as can be seen from retrospective review, was rather consistent, but clearly included two constituent elements:

Officially declared element – “right” policy – was characterized by continuous attempts to meet international standards in the approach to small business, but included no direct provisions.

The actually implemented policy was formed during the confrontation of businesses community and administrative system. This constituent element includes laws and regulations on simplified taxation methods, deregulation, and other pieces of legislation that had a significant positive impact. However, this element also includes

a defeat with licensing, when liberal provisions of the law were disfigured and distorted by subsequent regulations and currently we have sublicensing in Ukraine. This element includes weak executive discipline, lack of control and supervision over policy implementation, lack of liability for officials who adopt regulations that worsen small business environment. On the local level this element can be seen when executive authorities try to do their best to make it inconvenient for businesses owners to receive certain services. However, this constituent element is also seen when associations of small business owners successfully influence the resolutions of local councils regarding market-place rates, single and fixed tax rates.

That is to say that actual small business policy was formed as the balance of counterbalances of business community and those of administrative system.

In this situation we can say that the state does not govern the policy formulation process and, accordingly, does not assess its effectiveness. Although all successes and shortcomings are declared in the statements of key policy makers, there are no resulting consequences thereafter.

CONCLUSION: A program approach to small business development policy has been declared for the last 10 years. However, actual significant steps that brought about policy success were not anticipated by the government programs. Instead, they resulted from the pressure of business community (simplified taxation methods) or successful technical assistance projects supported by business community (deregulation).

6. SELF-REALIZATION OF SMALL BUSINESS SECTOR

Self-realization of interests and rights of small business sector is determined by its capability to self-organize and pressure state authorities.

These last years have witnessed increased activity of small business sector towards self-organization and enhanced effectiveness of civil society institutions that deal with small business sector problems.

A series of entrepreneurs' coalitions were created both on the national and regional level. Organizations of entrepreneurs demonstrate capacity to put constant pressure on policy makers and executive authorities. They also extensively use analytical and public mechanisms.

The examples of such pressure are as follows:

- Entrepreneurs' campaign against introduction of stamp duty (1999). The campaign resulted in the cancellation (on legislative level) of stamp duty, which was very burdensome for businesses.
- Campaign against the application of obligatory reporting and accounting forms (1999). On July 27, 1998, by the Decree #263, the State Committee of Statistics approved the model forms of primary accounting #KO-1 "Cash receipt" and #M-20 "Invoice for the sale of goods and material values" as obligatory

reporting documents. As a result of the campaign launched by business community the Decree was suspended (resolution of The State Committee on Entrepreneurship dated March 31, 1999, #17-24/3) as the one that “does not comply with the goal for support and development of small business and effective use of its prospective for the development of national economy”.

- Campaign against wide application of protective holograms (2000). The campaign resulted in significant revision of the list of documents and goods subject to mandatory protection by holographic elements. The list of documents subject to such protection was approved by the resolution of the Cabinet of Ministers of Ukraine on July 5, 2002, #932, and only a couple of issues remained unsolved – excise stamps and copies of quality/compliance certificates.
- Campaign on amending the Law of Ukraine “On the Use of Electronic Cash Registers and Cash Books” (2000). As a result of large scale public campaign and vigil of Ukrainian Parliament business owners did not allow to destroy the system of simplified taxation, reporting, and accounting for small businesses.
- Campaign against the adoption of the Draft Tax Code, which provided for the liquidation of the simplified taxation system (2001). As a result of this campaign the Draft Code was not adopted and representatives of business community were included in the task force group called to revise the Draft Tax Code.

It is very important, that lately small business sector organizations have been setting strategic tasks and goals. For example, in May 2002 Coordination and Expert Center of Entrepreneurs’ Associations of Ukraine initiated development of strategic document to outline the program of changes demanded by business community.

CONCLUSION: As the SME sector grows, entrepreneurs start to better understand their rights and interests. Sequentially, entrepreneurs put more pressure on state authorities in order to take use these rights and interests.

7. REACTION OF LOCAL AUTHORITIES AND BUSINESS OWNERS ON SMALL BUSINESS POLICY

7.1. Based on the analysis of surveys conducted by IFC during the last several years and expert materials prepared by business associations, we can name the barriers hampering business development on the local level.

- Taxes, the amount of which is set by the local council.
- Administrative pressure: inspections, permits, foisting administrative services.
- Violation of competition.

These barriers are typical for all Ukrainian regions.

However, local authorities in different regions react on these barriers differently.

Currently, only one of these barriers – issuance of permits – has the illustrative example of its overcoming on the local level. This example is related to creation of one-stop-shops in Mykolayiv, Ivano-Frankivs, and Kherson. Gathering specialists from all controlling authorities in one place to secure prompt adoption of the resolution on issuance of respective permits (the procedure that takes a lot of time and efforts in other cities) is a simple and very effective solution of the problem. However, such OSSs still do not resolve the in-depth problems of interference in operations of businesses.

Situation related to inspection of small businesses is much more complex.

Surveys prove that the average the number of inspections decreased over the last three years. But even despite this decrease the number of inspections is still excessive and things did not become much easier for businesses. There are constant attempts on the part of administrative system to evade existing procedure for conducting inspections established by the Decree of the President of Ukraine “On Certain Measures Regarding Deregulation of Business Activity”. Limiting the number of scheduled inspections resulted in shifting the focus to unscheduled inspections, which are not limited by the Decree. In other words, the substance of the Decree was replaced by the demonstration of willingness to literally fulfill its provisions. Moreover, law enforcement agencies (that are not deemed controlling authorities but actually perform controlling functions) are allowed not to abide by the list of grounds for conducting unscheduled inspections. This results in business owners losing a lot of time, undermines the effectiveness of their business and their trust towards the state.

Violation of the competition is also widely practiced through the creation of preferential conditions for “friendly” businesses, that is businesses controlled by some official or his/her affiliated persons. These preferential practices have different scale and instruments: from resolutions of local councils in favor of certain businesses to issuance of permits for placement or lease premises at privileged rates. To-date no systematic solution of this problem has been found. Perhaps, the best solution in this case would be free access to information on affiliated persons and resolutions adopted by respective authorities. However, this, in its turn, would require a more active and advanced structure of civil society.

7.2. How business owners overcome these barriers

First, as for setting tax rates by local authorities, in many cities this process goes publicly and business owners, through their organizations, learned to effectively influence local authorities. There are practically no cases when this issue is resolved through bribes or characterized by protectionism of “friendly” businesses.

Situation with the issuance of permits is somewhat different. Surveys show that ¼ of small business owners make illegal payments during the receipt of various permits. Another 20% of entrepreneurs leave this question without answer and, presumably, also pay bribes.

Also widely practiced is the system of foisting administrative services related to the issuance of permits. For example, to get the permit to work in certain premises business owners are required to attend paid fire safety courses. This is kind of legal

(since the requirement to undergo training courses are stipulated in respective regulation) way to get paid that replaces a commonplace bribe. However, since this is a legal requirement, it is much easier to limit payable amount.

Surveys also prove that far from always inspections result in bribes. The average of 10% of respondents answered that they bribed officials after the inspection. Expert assessment also show that inspectors often find minor violations that do not lead to severe sanctions and business owners just pay respective fines.

All in all, 28% of interviewed business owners acknowledged making illegal/unofficial payments and another 20% of respondents left this question without answer.

According to expert assessment, there are small businesses that run minimal risk of paying bribes in their daily operations. These are market vendors, the bulk of individual entrepreneurs. Entrepreneurs that work legally do not have to receive any permits; if they are fixed tax payers, they do not have to keep accounting and are not lucrative targets for inspections. As a matter of fact, law enforcement agencies are the only source of administrative pressure.

However, business owners that trade at marketplace are significantly vulnerable to changes in the amount of fixed tax. In case of significant increase of fixed tax rates or market place dues the number of legally operating businesses reduces greatly. Accordingly, the number of those who illegally operate “under the roof” of law enforcement agencies grows, since only law enforcement authorities are authorized to deal with people who engage in entrepreneurship without state registration.

Based on survey findings and expert assessment we can conclude that bribery does exist in Ukraine, but it is not so wide-spread.

CONCLUSION: Unreformed administrative system both on the local and central level, legally and illegally, creates administrative barriers in order to receive additional funds. But small business sector is no longer willing to play by the rules of the outdated administrative system. Therefore, it is small business sector that is mostly interested in the administrative reform.

8. GENERAL CONCLUSIONS REGARDING UKRAINE

- Small business sector in Ukraine has been established. It figures more and more prominently in social and economic policy of the state.
- The state has been declaring its intentions to support small business for the last 10 years.
- Realization by state authorities of their place in small business development is still on the stage of understanding that the state governs the process of sector development. However, there is progress from “support” to “promotion of development” in determining the role of the state.
- Despite the fact that the state deems itself the leader in formulating small business development policy, under the pressure of business community it created a series of mechanisms for cooperation with the sector. Small business sector uses these mechanisms to make an impact on the policy formation.

- The most successful solutions – simplified taxation methods, regulatory policy – were adopted as a result of active demands expressed by small business sector.
- Programming of the SME support policy (adoption of several programs on small business development) didn't have any effect on the sector due to lack of funding for implementation of such programs and non-compliance of program activities with top priority needs of small business sector.
- Key sector problems are administrative barriers and non-compliance of credit and financial mechanisms with the sector's needs.
- Administrative barriers result from the conflict between the unreformed administrative system and the growing SME sector consisting of independent business owners who are unwilling to play by the rules.
- It is exactly small business sector that is mostly interested in drastic administrative reform on both central and local levels.

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Part III. Analysis of SME Support Policy in Russia

This report provides an expert evaluation of the effectiveness of Russia's SME support policy. The evaluation is based on the analysis of characteristic features of small enterprise development during the years of 2000-2002 including analysis of its strong and weak points.

The conclusions in this document represent the views and opinions of business community in Russia.

1. Stages of Small Enterprise Development in Russia

(Political Priorities and Economic Results)

Since the collapse of the Soviet Union Russia and Ukraine have been searching for the optimal model of interaction between business and authorities, and trying to formulate their small enterprise policy. The short history of small enterprise development in Russia had several stages.

Stage 1: (1988-1991): USSR and the Russian Soviet Federative Socialist Republic adopted a number of laws favorable to small enterprise development. The state policy was directed at market liberalization. The “spontaneous” privatization was in progress (the privatization that many called the “*capturerazation*”). During this period, there was no system of institutional support to small enterprises. Moreover, the state agencies responsible for controlling and regulating market activities were just starting to operate or did not operate at all.

As a result the SME sector began to develop very rapidly - initially through the cooperative movement and then in the form of small enterprises.

Stage 2: (1992-1994): with the well-known political events happening in the country, this stage is characterized by adoption of a series of federal laws that laid the foundation for legal regulation of entrepreneurs' activities. The State Committee for Antimonopoly Policy and Small Enterprise Support became the coordinating institution for all small enterprise support agencies in the country. The first SME development program declared. Despite the wide range of intentions that were declared the program was never implemented.

The first SME support structures were created on the federal level (for example, the Enterprise Renaissance Center – the lead organization in the Russian SME Development Schools network. The state granted significant tax privileges to small businesses.

Under the circumstances, the number of SMEs continued to grow and reached 1 million.

Stage 3: (1995-1997). The federal law "On State Support to Small Enterprises" was adopted. The federal government approved and began to implement federal SME development programs. With moral (and in certain cases material) support of the state, SME support infrastructure began to develop (training/business centers, agencies for small business development, techno-parks, incubators). However, the red tape in the SME sector, too, began to grow. As did the tax pressure on SMEs. A new federal law changed the definition of a small enterprise. The new law defined small enterprises as corporations that had at least 75% of their collective investment fund consisting of contributions from private individuals and/or other small enterprises; or as private entrepreneurs who work without creating a corporation.

Small enterprises, beside other state institutions, were required to provide reporting to the statistics agencies. Individual entrepreneurs, on the other hand, were required to register only with the tax inspection. Since tax inspection's information is considered confidential, the data on individual entrepreneurs has never been taken into account or analyzed in state records. As a result, over the years the number of businesses in the official reports decreased to 840,000 and remained unchanged until recently.

Stage 4: (1998-2000). The default crossed out much of what had been achieved in the sphere of the market economy formation.

Small businesses in trade and service sectors suffered the greatest losses. Tens of thousands of private entrepreneurs went bankrupt. At the federal level, the state practically discontinued the attempts to create normal climate for small business development. At the same time, new possibilities emerged for small enterprises that operated in the production and service sectors. Regional authorities, finally, realized that small businesses could be an effective tool in solving regional social and economic problems. Practically all constituents of the Federation, as well as municipalities, began to develop small enterprise support programs. As a rule, those programs were declarative by their nature due to the lack of funds. Nevertheless, they were helpful in understanding the role and place of small business, as well as the support mechanisms. The non-government infrastructure for small business support continued to develop. Gradually, associations of entrepreneurs sprung throughout the country.

While the number of individual entrepreneurs grew, the number of small enterprises started to go down because of increasing administrative barriers and tax pressure.

Stage 5: (2000 to date) is characterized by the increased attention of the state to SMEs' problems.

The participation of Vladimir Putin, Russian President, in the First National SME Conference highlighted the new vector of the state policy, directed toward small enterprise development. In December 2001, the Council of Russian Federation approved the State Small Enterprise Development Concept. The Concept made the Russian government and numerous government agencies reconsider their approach to small enterprise development policy and their activities in this area. The new

legislation, called to reduce administrative barriers and to create favorable conditions for small enterprise development, was adopted during this period.

The number of individual entrepreneurs skyrocketed. By the end of 2001 the total number of small businesses in the country reached 5.5 million, or 37 per 1000 of population – close to the developed countries' average of 44 SMEs per 1,000 people. However, different evaluations and estimates showed that the SMEs' share in GDP remained significantly smaller than in other countries. Business associations started playing an important role in the dialog with authorities.

2. Current State of Small Enterprise Development in Russia

Until recently, official reports and studies pointed out the stagnation in small enterprise development (see Appendix 1). Such conclusions were based on the fact that according to the official statistics the number of small enterprises in Russian Federation (RF) does not grow, while in many regions it even decreases. However, individual entrepreneurs were not considered in those estimates while their numbers significantly increased during the last two years.

The federative law "On State Support to Small Enterprises" defines small businesses as:

- Individual entrepreneurs who work without creating a corporation;
- Farming enterprises;
- Small enterprises operating as corporations.

The Russian legislation and state statistics do not single out medium enterprises into a separate category.

According to the Tax Inspection's data 4,5 million individual entrepreneurs are registered in Russia to date.

Thus, if we consider only corporations, there are only 6 small enterprises in Russia per one thousand of population, while in EU countries this ratio doesn't go below 30. Only Moscow and St.-Petersburg came close to the Western countries' averages (21 and 24 small enterprises respectively).

However, if we take into account individual entrepreneurs the ratio will go up to 37 small businesses per one thousand of population, which brings Russia close to countries with well-developed market economy. The EU average is 45 enterprises per 1000 people.

We should also note that in most Western European countries small enterprises are defined as enterprises with maximum of 250 employees (in Russia – 100 employees). Both small and medium enterprises are legislatively defined in these countries. In Russia, however, medium enterprises are not legislatively defined and

therefore no official data is available on their number or their contribution to the economy.

The estimates of the Antimonopoly Ministry's Resource Center indicate that enterprises with less than 250 employees:

- constitute 90% of the total number of enterprises;
- provide 45% of all jobs;
- control 40% of the market (based on sales volume).

At the same time, the key indicators of SME development in Russia are far from those in the developed countries. For example, total tax revenues from small businesses constitute no more than 10 % of proceeds from all enterprises.

During 1999-2001 the number of people employed by small enterprises went down from 18,600,000 to 16,900,000 people. However, during the same period the number of individual entrepreneurs went up from 3,600,000 to 4,500,000.

The State Statistics Committee's data for 2001 shows the following breakdown of employment (including part-time and dual employment): individual entrepreneurs - 10,624,000; small enterprises – 7,621,000; medium and large businesses – 43,664,000.

Thus, small businesses' share in the overall employment of the population is 25% - half of the Western Europe's average of 40-50%. Moreover, during the last years Russia has been lagging behind most Eastern European countries, too.

Based on the available statistics and data of the Tax and Duty Ministry one can estimate the share of small businesses in the overall sales revenue (millions of Rubles, for the year 2001): small businesses – 35,3%, individual entrepreneurs – 2,2%, large and medium enterprises – 62,5%.

Small businesses' industry breakdown and the number of jobs indicate that small enterprise is developing predominantly in the sector of trade and public catering. Other sectors, including innovative enterprises, develop slowly.

The industry breakdown in the SME sector remains practically unchanged from the times when the first small businesses emerged.

Trade and public catering remain the most popular types of business among small enterprises. Moreover, the share of these enterprise in the SME sector continues to grow - from 1997 to 2001 it increased by 3% and by January 1, 2002 reached 46,3%.

The number of people employed in the trade and public catering sectors also has grown. In 2002 these sectors accounted for 34,2% of all people employed in small enterprises.

Industry and construction are the other popular sectors among SMEs. The share of small enterprises in these sectors are 15,35 and 14,4% respectively. The industry sector accounts for 21,3% of all jobs in small businesses, the construction sector – 20,8%. 27,4% of small enterprises' total output (products and services) is produced in the industry sector.

The number of small enterprises in scientific and engineering areas amounted to 30.9 thousand or 3,6% of the total number of small enterprises as of January 1, 2002, which is not very high. Compared to 1999 the number of small enterprises engaged in scientific research and related services decreased by 16,7%. The number of people employed by such businesses decreased by 7,6% and constituted 192 thousand (2,5% of the total number of people employed at small enterprises).

Despite the fact that the number of small businesses and the number of jobs in the sectors of industry and scientific research does not grow, small enterprises have their niche on the market meeting the demand for customized products and services, including innovative products.

Small businesses are less active in their investment policy compared to large and medium enterprises. The share of small enterprises in the total volume of fixed capital investment constitutes only about 3%.

The level of small enterprise development in Russia's regions is very diverse while SMEs' potential is not used equally for regional economic development.

The shadow sector remains a characteristic feature of Russia's small enterprise development. Various estimates indicate that the shadow sector constitutes 30% to 50% of the actual turn-over in small business sector (without medium and large enterprises).

CONCLUSIONS

1. Despite difficulties and contradictions, Russia's policy developed in the direction of small business support.
2. The state small enterprise support policy has been inconsistent and contradictory, with declaration of support on the one hand, and laws and decisions that significantly worsened the position of small businesses on the other.
3. As civil society and market economy developed, regional and local administrations became key players in the SME development process. Although initially they ignored signals coming from the central authorities to stimulate small business development, at the last stage they became the most consistent advocates of this development. Thus, the small enterprise support system is gradually formed.
4. Quantitative indicators prove the level of small business development in Russia to be close to that of countries with the developed market economy.
5. At the same time, based on the number of jobs and GDP share, Russian experts believe small businesses to be significantly underdeveloped in Russia compared to other countries.

6. As a result of short history of small business development in Russia and ineffectiveness of small business support policy of the state, most small businesses achieved success not due to but rather in spite of the state policy.

3. THE SMALL BUSINESS SUPPORT POLICY:

ESSENCE AND EFFECTIVENESS

The small enterprise development is impeded by numerous problems. The key ones are:

- legislation, which is unstable and does not stimulate honest business;
- administrative barriers, red tape and large numbers of structures and officials who are authorized to make decisions concerning small business start-up and functioning;
- lack of access to assets, resources and investment;
- lack of qualified market-oriented personnel;
- lack of effective and objective information.

These problems were discussed at the Second and Third National SME Conferences in Russia (“Reasonable Regulation for Civilized Entrepreneurship”, 2001, “Resource Support for Small Business”, 2002, See Appendixes 2 and 3).

To date Russia has failed to create SME-friendly environment.

At the same time, we must admit that the Russian Federation has succeeded in the formation of a **nation-wide** small enterprise support system.

The Russian Ministry of Antimonopoly Policy and State Support for Small Business became the coordinating state institution for small business development. There are also structural departments responsible for certain aspects of small business development at the Economy Ministry, Labor Ministry, Industry and Science Ministry, Education Ministry, and Russian Academy of Sciences.

The issues of state support to small businesses are regularly discussed at the meetings of the Russian government and various committees in the parliament.

In December 2001 the State Council under the Russian President discussed the small business development issues and approved the National Small Business Support Concept (Appendix 4).

According to the law #8 “On State Support to Small Businesses” adopted in 1995, the support of the state is provided through federal programs. Currently the Russian government is implementing the 4th Federal Program. The development of the program was requested by the Federal Small Enterprise Support Fund, which has been operating since 1993. The fund is also the key financial instrument for the program’s implementation.

Beside the national small enterprise support system, a similar support system has been created on the regional level. It consists of specialized agencies and institutions that operate in 88 constituents of the Russian Federation.

The structure of the institutions that provide support to small businesses in various regions is different. In different constituents of Russian Federation small enterprise issues are managed both by various subdivisions of the executive agencies and independent divisions such as departments, ministries, committees, etc. Some regions have created special executive institutions to deal specifically with SME issues (departments, committees on entrepreneurship, in Chuvash Republic – Business Support Ministry).

Recently, SME support in Russia's regions has become very dynamic. Numerous councils, coordination committees and working groups have been operating under the local governments.

Russian Federation constituents have also adopted and are further developing various laws and regulations aimed at small enterprise development – the laws on small enterprise support, on introduction of the single tax for temporary income (based on the frame federal laws), other laws, as well as resolutions of executive bodies of local governments, including regional support programs.

More and more municipalities, too, adopt specialized small enterprise support programs.

However, experts and entrepreneurs deem the government's actions inconsistent and ineffective.

For example, the general public in Russia was surprised by the introduction of the single social tax at the end of 2001 as it significantly increased the tax burden on individual entrepreneurs.

Adoption of laws that simplify licensing, registration and certification procedures for small businesses have been followed by attempts to create additional barriers on the by-laws level.

Despite nationwide discussions about the need for SME support, the Russian government imposed such high excise taxes on gas stations that this whole sector became inaccessible to small enterprises. There is evidence that this case is not an accident but rather a policy imposed by 'oligarchs', who wish to control markets and concentrate their capital in the most profitable industries.

The existing federal small enterprise support programs are underfunded and unable to influence the development of the situation.

Overall, authorities and community show dual attitude toward the SME sector. On the one hand, they perceive small businesses as a group of not so honest people who are always ready to steal whatever they can't get legally. On the other hand, they

try to exploit SMEs by making them pay numerous official and not-so-official taxes and fees – the money that the country needs so desperately to survive and develop.

Regional SME support efforts, as a rule, are limited due to the lack of funding. Only a handful of regions allocate significant funds in their budgets for the small enterprise support and development (Moscow, Hanty-Mansiysk, St. Petersburg). Other regions so far have only declared their intentions to provide funds for the small enterprise development.

The current situation with proceeds to the budget makes many believe that these tendencies will hardly change in the near future.

For example, experts believe that the Russian government intentionally delays approval of the federal Small Business Support Program for 2003-2005.

CONCLUSIONS:

1. Although the key elements and attributes of the small enterprise support system have been created both on the federal and regional levels, overall this system is ineffective. This may be explained by the lack of experience and motivation on the regional and municipal levels.
2. On the federal level, despite President's small business support efforts, the Russian elite (represented by the federal government) does not perceive small business as a sector worth of strengthening and funding. So far the main vector of the country's economic development is based on raw materials markets, while small enterprises' interests remain on the 'outskirts' of the Russian government's policy. It seems as the Russian President's efforts to support SMEs are not fully implemented by the enormous bureaucratic mechanism ruling the country.
3. Financial and industrial groups use hidden influence mechanisms to prevent the adoption of certain laws or regulations that would create favorable conditions for small businesses. That's why the most important thing for SME development is their consolidation and ability to formulate and lobby their interests before the government.
4. There are no clear and well-defined procedures for collecting feedback from the community when developing a new law or regulation. The government officials bear no responsibility for actions or lack of actions that result in losses to SMEs. The proposal to introduce obligatory assessment of draft-laws by organizations of entrepreneurs is quite appropriate. The proposal can be implemented by the Presidential Order or a special law.

4. MAIN DIRECTIONS OF CURRENT SMALL ENTERPRISE SUPPORT POLICY IN RUSSIA

According to Article 7 of the Federal Law "On Government Support to Small Businesses in Russian Federation" such support is realized through implementation of

activities specified in federal, regional (inter-regional), industry-specific (inter-industry) and municipal small enterprise support and development programs.

Currently the Russian government is implementing the Federal Small Enterprise Support Program for 2000-2001 (the program's implementation has been extended for 2002).

The main goal of the Federal program for 2000-2002 is to create favorable conditions for small enterprise development by improving the quality and effectiveness of government's support efforts on the federal level.

The Federal Program is implemented in 6 areas, which are the priority areas in the state small enterprise support policy:

A. Regulatory and legislative support for small enterprises

The state support to small enterprises in Russia is realized through a system of laws and regulations that includes the Constitution, a series of federal laws such as the law "On Entrepreneurship Support in Russian Federation", executive orders of the Russian President and decrees of the Russian government.

At the same time the previous experience shows that the effective functioning of existent and newly-created small enterprises requires further improvement of laws and regulations that govern their operations, specific work conditions, as well as relations with state institutions and other businesses.

During 2000-2001 and throughout this year, small business development efforts have been focused on the following areas:

- Improvement of specific laws that regulate small enterprise support issues;
- Legislative support for elimination of administrative barriers in small enterprise development;
- Improvement of tax legislation;
- Bringing relevant laws and regulations of the Federation's constituents in line with the federal legislation.

All attempts to amend the outdated law "On Support to Small Businesses in Russian Federation" have failed. This is primarily explained by the existing legal collisions and contradictions between different laws, including the Budget Code, the law "On Banking Activities" and others.

At the same time Russian Parliament adopted federal laws "On Protection of Corporations' and Individual Entrepreneurs' Rights in the Course of State Inspections", "On Licensing Certain Types of Businesses" and "On State Registration of Legal Entities".

The federal law “On Protection of Corporations’ and Individual Entrepreneurs’ Rights in the Course of State Inspections” was called to set limits for government agencies when they conduct inspections of businesses and thus to eliminate administrative barriers that hamper business development. The law has fundamentally changed the approach to state control over business and has introduced accountability of government agencies for unlawful acts.

The federal law “On Licensing Certain Types of Businesses” simplified market entry procedure for newly-created enterprises and created conditions for stable operation of businesses. The federal law significantly reduces the number of businesses subject to licensing. It also simplified licensing procedure on the territory of the Russian Federation. As a result, the new law has eliminated unnecessary limitations and administrative barriers that prevented entrepreneurs from working to their full capacity.

The federal law “On State Registration of Legal Entities” has introduced a new approach to business start-up – ‘one window registration’ (registration in one agency). The new law also reduces the duration of state registration to 5 days. The registration agency can deny the application only if the applicant didn’t submit all documents stipulated by the federal law, or if the submitted documents are not properly formalized.

In order to improve relevant laws and regulations, one needs to continually monitor current federal and regional legislation, and to identify the laws and regulations that impede freedom of enterprise.

Taxation is a key element for SME support. To-date 3 different taxation systems apply to small enterprises in Russia:

- The general system, under which small enterprises pay income tax, VAT, property tax and other types of taxes;
- Simplified taxation/accounting/reporting system, introduced by the federal law “On Simplified Taxation, Accounting and Reporting System”;
- Single tax on temporary income for certain types of businesses introduced by the federal law ‘On Single Tax on Temporary Income in Certain Types of Businesses’.

Recently the Federation Council adopted a law that introduces a simplified taxation system for small businesses with turnover under 15 million rubles.

As the First Russian National SME Conference (March 2000) showed, the effectiveness of the single tax system depends largely on local governments. For example, in some regions (Altaisky Krai, Kaluga, Sverdlovsk and Volgograd Oblasts) the law proved to be effective as it increased proceeds to the regional budget and thus brought funds for small business development. In other regions, however, the local legislation does not allow small enterprises take advantage of the new federal law (Ulianov, Kostroma and Voronezh Oblasts). The economic reasoning for setting the rate of temporary income tax remains a major issue.

B. Financial/credit support to small enterprises and the development of progressive financial technologies

The financial support to small businesses on the federal level is provided by the Federal Small Enterprise Support Fund. Using budgetary and non-budgetary sources, the Fund implements the Federal Small Business Support Program.

On the regional and municipal levels this function is carried out by the regional and municipal small enterprise support funds implementing regional/municipal small enterprise support programs.

The key aspects of credit and investment support to small businesses over the last several years were:

- Various forms of lease financing, leasing schemes;
- SME self-finance systems (credit union, reciprocal insurance unions, etc);
- Microfinance.

Small businesses' access to bank loans is limited due to the strict collateral requirements, lack of credit history and high risks for the banks. Banking sector is oriented predominantly on large enterprise financing, which makes small business loan servicing very costly and results in high interest rates.

Creation of favorable lending conditions and the overall improvement of the Russian financial market do not exclude the necessity for preserving special financial support mechanisms such as small enterprise support funds. Such funds have been successfully operating abroad.

One of the problems that small enterprises have is the lack high-tech assets. This problem could be solved by equipment lease, which would allow small companies use modern equipment and technologies without having to apply for loans.

Despite relatively small share of government funds invested in the creation of regional leasing companies small business-oriented leasing operations bring positive results. Monitoring of 9 regional leasing companies that work with SMEs showed that the average share of small businesses among the companies' clients constituted 61.5%. Of all contracts that were signed by the 9 companies 28.2% were for transportation vehicles, 27% - commercial refrigeration equipment, 8.6% - computers and office equipment, only 4.5% - production equipment, and 1.3% - farming equipment.

Microfinance, or quick access to credit resources in relatively small amounts, is very important for small businesses and private entrepreneurs. According to the estimates of the SME Resource Center, the volume of Russia's microfinance market is about 7 billion US dollars.

In 1998-2002 various foreign and international organizations have been supporting several microfinance programs on regional levels equaling about \$100 million.

Here are some key figures on the microfinance programs in Russia:

- Average monthly interest rate – 6%;
- Average loan size – 12.5 thousand rubles;
- Average amount per one client – 20 thousand rubles;
- Average repayment rate – 95%;
- Loan breakdown: trade – 55%, services – 24%; farming – 11%.
- 63% of all loans are made to start-ups.

The implementation of microfinance programs in the regions has showed high demand for such services not only among low-income entrepreneurs but also among small enterprises interested in quick financial resources. Nevertheless, commercial banks abstain from developing micro-lending products. As a result, most microfinance services are provided ‘informally’ so that the profit accrued from disbursement of micro loans is not recorded and is not taxed.

A significant investment resource for small enterprises is the market of non-banking capital, including the system of credit unions (credit cooperatives), which has been an effective mechanism for attracting free capital. Today more than 700 such unions operate throughout Russia.

Overall, entrepreneurs believe that the state financial/credit support to small business is unsatisfactory and should be further developed in the following 2 areas: loan guarantees and loan compensations to commercial banks.

Despite numerous attempts, the guarantee mechanism for investment loans to small enterprises has not been developed, including state guarantees to commercial banks participating in the financing of the small business sector.

C. Reduction of administrative barriers

The existing regulation of business requires from entrepreneurs an unreasonably high amount of time and money for registration, obtaining various permits, approvals, licenses, certificates, accreditations and dealing with inspections that obstruct normal operation of their businesses.

According to the results of the poll conducted by the Russian Independent Institute of Social and National Issues in Moscow, St. Petersburg and Nizhniy Novgorod, almost 40% of respondents blamed tax inspectors for their limited knowledge of legislation, and 14% blamed them for the open extortion.

Almost half of respondents said that they would give a bribe to a tax inspector only as a last resort. Those who give bribes usually spend no more than 10% of their annual profit on them.

As a key element of economy modernization, the Russian federal government defined the shift of administrative regulation focus from the universal preventive inspections (which proved to be ineffective in most cases) to selective inspection of businesses.

Complexity and significant costs remain the main issues with the SME registration procedure. The status of a 'small enterprise' also remains unclear, since it is not an organizational form of a legal entity. Bureaucratic pressure is being reduced through unification of registration procedures on the local level.

Certification and licensing is a major problem for every forth production-oriented small enterprise and every third trade-oriented small business. This problem is caused by the high cost of paperwork preparation (conducting examinations, collecting various certificates and approvals), and by inconsistent approach to setting the prices (hidden monopolization of the sector by consulting and legal firms that are somehow connected with the local authorities).

Several dozens of various state agencies conduct inspections and audits of small businesses. On the federal level more than 50 agencies perform such functions.

40 constituents of the Russian Federation have created special commissions for reduction (elimination) of administrative barriers. Most successfully such commissions have been operating in Tomsk Oblast, City of Moscow, Kaliningrad Oblast, Komi Republic, Khabarovsk Krai, Volgograd Oblast and others. Organizations of entrepreneurs, as well as individual entrepreneurs, participate in the commissions' work. The main result of their work is the development of harmonized regulations that will influence business development in the region. The Administration of the Russian President is also creating a network of similar commissions under the offices of authorized representatives of the President in federal districts.

Introduction of the Inspection Log Books has significantly changed the inspectors' conduct. The log books partially solve the bureaucracy problems in the inspection system and lay a foundation for creation of a state control mechanism that wouldn't violate entrepreneurs' rights.

Reduction and elimination of administrative barriers concurs with the draft State Development Strategy Until 2010, developed by the Center for Strategic Studies. Among other things, the strategy stipulates the reduction of small business inspections, simplification of the approval procedure for investment projects, and clarification of the procedure for privatization of land and premises where the enterprises are located.

D. Formation of small business support infrastructure

Small business support infrastructure includes specialized institutions of various types – informational, educational, research, technological, cooperation-facilitating and others.

The small enterprise support infrastructure has 4 levels: federal, inter-regional, regional and municipal.

Regional level of the support infrastructure is the most developed one. At the same time, distribution of the infrastructure's elements in the regions is very uneven.

Certain elements of the infrastructure may be absent in one region while the other region may have too many of them, which leads to duplication of functions.

In Russian Federation's constituents operate 82 regional small enterprise support funds, 160 municipal funds, 51 regional small enterprise support agencies, about 50 municipal small enterprise support agencies, 80 business incubators, 59 educational business centers of the Morozov Project with 150 branches in different towns, 64 informational and analytical centers, about 30 innovation centers, over 20 trade chambers, 41 techno parks, 54 regional leasing companies, about 70 municipal leasing companies, and 64 regional marketing centers.

The market of informational products and services has been generally formed in Russia. The most advanced sector on this market is the business information sector. Russian entrepreneurs work in an entirely new informational environment and have access to a significant number of informational services offered on the international market. At the same time, numerous attempts to create a single informational SME support system have so far brought no positive results.

Informational support to small businesses is provided by various industrial, regional and commercial informational systems and structures, that were created by different projects and that practically don't communicate with each other. Meanwhile, within the Federal Small Enterprise Support Program, the Russian Agency for Small Enterprise Support has created an small business electronic informational exchange network (SIORA). The network uses the Internet as the foundation for further development of informational small enterprise support structure (1996-1997 and 1998-1999).

The SIORA network consists of the centralized server/portal of the Russian Small Enterprise Support Agency and web-servers of regional small enterprise support agencies in over 50 constituents of the Russian Federation. The servers contain information categorized specifically for entrepreneurs working in the regions and entrepreneurs working on federal, inter-regional and international markets.

Western information companies have been increasingly active in offering their technologies for the collection, processing and dissemination of informational products. These companies also start adapting their products to the Russian market.

The TESIS Project (SMERUS 96-02) has opened 5 Business Information Centers that provide informational consulting services, conduct trainings for entrepreneurs and promote products on the markets (Chuvash Republic, Moscow, Cheliabinsk, Barnaul and Voronezh).

An important step in the development of informational support to small businesses has been the creation of a system for collecting and disseminating information about SMEs based at the SME Resource Center, which operates within the TESIS project of the European Union. SME support organizations and entrepreneurs have access to up-to-date information about the SME sector on the federal level, as well as to regional information resources.

In most regions operate networks of educational institutions that provide training services to SMEs.

According to the Labor Ministry, in 2000-2001 38.6 thousand people have been trained in basic business skills. As a result, 54.5 thousand formerly unemployed people now have jobs. 43.9 thousand of them chose to become private entrepreneurs, 10.7 thousand people started small enterprises (farms), and over 1.2 thousand people have found jobs in small businesses.

A large-scale program to train specialists for market economy has been the Morozov Project, which the Market and Management Academy has been implementing since 1992.

The Morozov network includes 59 regional training centers, 20 business incubators, and 67 municipal training/business centers that became an important element in regional small business support infrastructure. The consultants of the training/business centers provide services both to already existent businesses and start-ups. Within the Morozov Project every year more than 35,000 entrepreneurs receive various types of training and consulting services. The project has accumulated an enormous amount of experience in training of trainers and consultants. It has also developed unique training materials.

Experts estimate that 250-350 thousand people should be trained each year for the SME sector in order to meet the demand of the growing market economy. This will require creation of permanent training and consulting structures that will have inter-regional credence.

5. GENERAL CONCLUSIONS ON RUSSIA

1. Small business in Russia has become not only a social and political phenomena but also an economic one. The contribution of small enterprises to the Russian economy tends to increase.
2. The Russian President demonstrates a strong commitment to small enterprise development (see Appendix 5).
3. The state small enterprise support system is being gradually formed. The focus of this system has already shifted from the centre to the regions and it continues to shift towards the municipal level.
4. Small enterprises not only grow in numbers but also grow professionally. They seek to create mechanisms for an effective dialogue with authorities.
5. The ineffectiveness of the state small enterprise support policy is explained partly by the lack of experience and partly by the resistance of large capital that focuses on raw material markets.
6. Mechanisms for forecasting consequences of new laws and regulations remains underdeveloped, as are the criteria and methods for assessing the effectiveness of small enterprise development activities. Federal and regional small enterprise support programs lack proper funding.
7. The analysis of modern tendencies indicates that the role and the share of small enterprises will undoubtedly continue to grow, however it will happen not at once

but as a result of a competition and struggle between business community and bureaucrats, and a conflict between the interests of millions of entrepreneurs and hundreds of financial and industrial groups' representatives.